90-812

No. _____

In The

Supreme Court of the United States

October Term, 1990

CALIFORNIA STATE BOARD OF EQUALIZATION,

Petitioner,

v.

HAROLD S. TAXEL, Trustee in Bankruptcy,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

United States Bankruptcy Code section 541 (11 U.S.C. § 541) defines property of bankruptcy estates.

United States Bankruptcy Code section 362 (11 U.S.C. § 362) prohibits collection of debts from property of bankruptcy estates.

California Revenue and Taxation Code section 6701 allows Petitioner California State Board of Equalization ("the Board") to require taxpayers to place certificates of deposit with the Board to insure compliance with the California Sales and Use Tax Law.

California Revenue and Taxation Code section 6815 allows the Board to apply such certificates of deposit to pay liabilities owing under the California Sales and Use Tax Law.

The question presented is whether a certificate of deposit placed with the Board under California Revenue and Taxation Code section 6701 by a taxpayer prior to its bankruptcy and cashed by the Board under California Revenue and Taxation Code section 6815 during the taxpayer's bankruptcy was property of the taxpayer's bankruptcy estate as defined by United States Bankruptcy Code section 541 and as protected by United States Bankruptcy Code section 362.

LIST OF PARTIES

The parties to the proceeding in the court whose judgment is sought to be reviewed are as follows:

1. Petitioner California State Board of Equalization; and

2. Respondent Harold S. Taxel, Trustee in Bankruptcy ("Taxel").

Taxel is the trustee in bankruptcy of Sluggo's Chicago Style, Inc., which was not a party to the proceeding in the court whose judgment is sought to be reviewed.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner California State Board of Equalization ("the Board") respectfully prays that a writ of certiorari issue to review the opinion and judgment entered by the United States Court of Appeals for the Ninth Circuit in the above-entitled proceeding on August 27, 1990.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit (Appendix A, *infra*) is reported at 912 F.2d 1073.

The opinion of the United States Bankruptcy Appellate Panel of the Ninth Circuit (Appendix B, *infra*) is reported at 94 B.R. 625.

JURISDICTION

The date of the judgment sought to be reviewed and the time of its entry were August 27, 1990.

The statutory provision believed to confer on this Court jurisdiction to review the judgment in question by writ of certiorari is 28 U.S.C. § 1254(1).

STATUTES INVOLVED

11 U.S.C. § 362(a):

> "Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities, of –
>
> (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
>
> (2) the enforcement, against the debtor or against property of the estate, of a judgment

obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor."

11 U.S.C. § 541(a)(1):

"The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case."

11 U.S.C. § 541(c)(2):

"A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."

28 U.S.C. § 959(b):

"Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof."

28 U.S.C. § 960:

"Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation."

Cal. Rev. & Tax. Code § 6701:

"The board, whenever it deems it necessary to insure compliance with this part, may require any person subject thereto, to place with it such security as the board may determine. The amount of the security shall be fixed by the board but, except as noted below, shall not be greater than twice the estimated average liability of persons filing returns for quarterly periods or three times the estimated average liability of persons required to file returns for monthly periods, determined in such manner as the board deems proper, or ten thousand dollars

($10,000), whichever amount is the lesser. In case of a person who, pursuant to Section 6070 of this part, has been given notice of hearing to show cause why his permit or permits should not be revoked, or a person whose permit or permits has been revoked or suspended, the amount of the security shall not be greater than three times the average liability of persons filing returns for quarterly periods or five times the average liability of persons required to file returns for monthly periods, or ten thousand dollars ($10,000), whichever amount is the lesser. The limitations herein provided apply regardless of the type of security placed with the board. The amount of the security may be increased or decreased by the board subject to the limitations herein provided. The board may sell the security at public auction if it becomes necessary so to do in order to recover any tax or any amount required to be collected, interest, or penalty due. Notice of the sale may be served upon the person who placed the security personally or by mail; if by mail, service shall be made in the manner prescribed for service of a notice of a deficiency determination and shall be addressed to the person at his address as it appears in the records of the board. Security in the form of a bearer bond issued by the United States or the State of California which has a prevailing market price may, however, be sold by the board at private sale at a price not lower than the prevailing market price thereof. Upon any sale any surplus above the amounts due shall be returned to the person who placed the security."

Cal. Rev. & Tax. Code § 6815:

"If at the time a business is discontinued the board holds security pursuant to Section 6701 in the form of cash, government bonds, or insured

deposits in banks or savings and loan institutions, such security when applied to the account of the taxpayer shall be deemed to be a payment on account of any liability of the taxpayer to the board on the date the business is discontinued."

STATEMENT OF THE CASE

On April 9, 1984, Sluggo's Chicago Style, Inc. ("the taxpayer"), placed with the Board security, as required by California Revenue and Taxation Code section 6701, in the form of a certificate of deposit payable to the Board in the sum of $9,100.00.

On November 26, 1984, the taxpayer commenced its bankruptcy case.

On February 28, 1986, the taxpayer discontinued its business. On that date, the taxpayer was indebted to the Board under the California Sales and Use Tax Law in an amount in excess of $9,100.00.

On August 1, 1986, the Board presented the above certificate of deposit to the depository bank for payment to the Board, and the depository bank paid the Board the sum of $9,016.02 (the face amount of the above certificate of deposit ($9,100.00) plus accrued interest of $41.14 minus a penalty for withdrawal between periodic maturity dates of $125.12).

Thereafter Respondent Harold S. Taxel, the taxpayer's Trustee in Bankruptcy ("Taxel"), filed in the United States Bankruptcy Court for the Southern District of California a complaint seeking to have the Bankruptcy Court order the Board to turn over to Taxel the proceeds

of the above certificate of deposit. Taxel invoked the jurisdiction of the Bankruptcy Court under 28 U.S.C. §§ 157 and 1334.

Taxel and the Board stipulated to the facts and then brought cross-motions for summary judgment on the stipulated facts. The Bankruptcy Court granted Taxel's motion, denied the Board's motion, and entered summary judgment that the Board turn over to the bankruptcy estate of the taxpayer the sum of $9,100.00, plus interest, in the form of a new certificate of deposit.

The Board appealed from this judgment to the Bankruptcy Appellate Panel of the Ninth Circuit. The Bankruptcy Appellate Panel entered judgment affirming the judgment of the Bankruptcy Court.

The Board appealed from the judgment of the Bankruptcy Appellate Panel to the United States Court of Appeals for the Ninth Circuit. The Court of Appeals entered judgment affirming the judgment of the Bankruptcy Appellate Panel.

REASONS FOR GRANTING THE WRIT

I

THE DECISION OF THE COURT OF APPEALS IN THE PRESENT CASE CONFLICTS WITH THE DECISION OF ANOTHER UNITED STATES COURT OF APPEALS AND RELIES UPON AN OVERRULED DECISION OF THE UNITED STATES SUPREME COURT

Selby v. Ford Motor Co., 590 F.2d 642, 648-649 (6th Cir. 1979), held that a fund created by statute for the benefit of certain creditors of the debtor is a trust fund which is

not property of the bankruptcy estate. The opinion of the Court of Appeals in the present case (Appendix A, *infra*) accurately states the holding of *Selby*, does not attempt to distinguish the present case from *Selby*, but then says:

> "*United States v. Randall*, 401 U.S. 513 (1971), however, supports a contrary position."

The opinion then decides the present case under *United States v. Randall*, 401 U.S. 513 (1971). However, in *Begier v. I.R.S.*, 495 U.S. ___, ___, 110 S.Ct. 2258, 2266, 110 L.Ed. 2d 46, 60 (June 4, 1990), the United States Supreme Court had already overruled *Randall* in the following words:

> "The strict rule of *Randall* thus did not survive the adoption of the new Bankruptcy Code."

But unless the Supreme Court grants the present petition for writ of certiorari, the strict rule of *Randall* (against recognizing statutory trust funds for taxes) would indeed survive the adoption of the new Bankruptcy Code, at least in the Ninth Circuit.

Therefore, the decision of the United States Court of Appeals in the present case conflicts with the decision of another United States Court of Appeals (*Selby*) and relies upon an overruled decision of the United States Supreme Court (*Randall*).

II

AS THE CERTIFICATE OF DEPOSIT WAS A TRUST FUND WHICH WAS NEVER PART OF THE TAXPAYER'S BANKRUPTCY ESTATE, THE BOARD PROPERLY CASHED IT

On April 9, 1984, the taxpayer placed with the Board security, as required by California Revenue and Taxation

Code section 6701, in the form of a certificate of deposit payable to the Board in the sum of $9,100.00. App. 27, 29. Cal. Rev. & Tax. Code § 6701, first sentence, provides:

> "The board, whenever it deems it necessary to insure compliance with this part [the California Sales and Use Tax Law], may require any person subject thereto, to place with it such security as the board may determine."

The face of the above certificate of deposit showed an unrestricted transfer of $9,100.00 from the taxpayer to the Board. App. 29. The factual context (App. 27) and the applicable law (Cal. Rev. & Tax. Code §§ 6701, 6815) supplied the only restriction on the use of the above $9,100.00 – that it be used only to pay the taxpayer's sales and use tax and only when the taxpayer discontinued business. Cal. Rev. & Tax. Code § 6815 provides:

> "If at the time a business is discontinued the board holds security pursuant to Section 6701 in the form of cash, government bonds, or insured deposits in banks or savings and loan institutions, such security when applied to the account of the taxpayer shall be deemed to be a payment on account of any liability of the taxpayer to the board on the date the business is discontinued."

Thus, on April 9, 1984, the above certificate of deposit became the property of the Board subject only to the Board's obligation to use such certificate in the manner required by law.

On November 26, 1984, the taxpayer commenced its bankruptcy case. App. 9. Bankruptcy Code section 541, defining property of the bankruptcy estate, is not intended to expand the debtor's rights against others more than they exist at the commencement of the case. H.

Rep. No. 95-595, p. 367, reprinted at 9 Bkr. Service – L.Ed., Legislative History § 82:17, p. 379; *In re Paukner*, 10 B.R. 29, 33 (Bk. Ct. N.D. Ohio 1981). The bankruptcy estate succeeds to no more interest than the debtor possessed or had. *In re Baquet*, 61 B.R. 495, 497 (Bk. Ct. D. Mont. 1986). Thus, the taxpayer's commencement of its bankruptcy case did not shift the ownership of the certificate of deposit from the Board to the debtor's estate.

Moreover, since the taxpayer did not discontinue its business when it went into bankruptcy, it needed to maintain the security placed with the Board prior to bankruptcy. 28 U.S.C. § 959(b) provides:

> "Except as provided in section 1166 of title 11 [which section is not relevant to the present dispute], a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof."

Such court-appointed person must comply with a state law requiring the placing of security for taxes with a state tax agency. *Gillis v. California*, 293 U.S. 62, 63-67 (1934). 28 U.S.C. § 960 provides:

> "Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation."

A debtor in possession is an officer of the bankruptcy court and is fully subject to taxes incurred during his operation of a business. *Nicholas v. United States*, 384 U.S. 678, 690 (1966). "The statute [28 U.S.C. 960] 'indicates a Congressional purpose to facilitate – not to obstruct – enforcement of state laws.' " *Cal. State Bd. of Equalization v. Sierra Summit*, 490 U.S. ___, ___, 109 S.Ct. 2228, 2234-2235, 104 L.Ed. 2d 910, 920 (1989). Accordingly, the taxpayer had to maintain its pre-bankruptcy tax security since it continued to operate its business.

On February 28, 1986, the taxpayer discontinued its business and was indebted to the Board under the Sales and Use Tax Law of the State of California in a sum in excess of $9,100.00. On August 1, 1986, the Board cashed the above certificate of deposit. App. 27. The placing of this security with the Board prior to bankruptcy was required by state law. Cal. Rev. & Tax. Code § 6701. The maintaining of this security in bankruptcy was required by federal law. 28 U.S.C. § 959(b); *Gillis v. California, supra*, 293 U.S. 62, 63-67. Surely, federal law does not require the maintaining of security as an idle act which will never benefit the secured party.

Rather, a fund created by statute for the benefit of certain creditors of the debtor is a trust fund which is not property of the bankruptcy estate. *Selby v. Ford Motor Co., supra*, 590 F.2d 642, 648-649; *In re Pelham Fence Co. Inc.*, 65 B.R. 924, 926-928 (Bk. Ct. S.D. N.Y. 1986); *In re Marona*, 54 B.R. 65, 66-68 (Bk. Ct. N.D. Ala. 1985); *Matter of Lenk*, 48 B.R. 867, 869-871 (Dist. Ct. W.D. Wisc. 1985); *Matter of Lenk*, 44 B.R. 814, 816-817 (Bk. Ct. W.D. Wisc. 1984) (same case). Bankruptcy Code section 541 (11 U.S.C. § 541) does not affect statutory provisions that create a trust fund for

the benefit of a creditor of the debtor. H. Rep. No. 95-595, p. 368, reprinted at 9 Bkr. Service – L.Ed., Legislative History § 82:17, p. 380.

Where one person gives money to another person for a certain purpose (for example, the payment of a debt), the second person receives the money in trust to apply it to the intended purpose. *In re Mahan & Rowsey, Inc.*, 817 F.2d 682, 684 (10th Cir. 1987); 76 Am. Jur. 2d, Trusts § 233 (1975). Statutory trusts are not assets of a bankrupt's estate. *In re Allgeier & Dyer, Inc.*, 18 B.R. 82, 85 (Bk. Ct. W.D. Ky. 1982).

The opinion of the Bankruptcy Appellate Panel in the present case (Appendix B, *infra*) seems constrained to decide whether the certificate of deposit was security *or* a statutory trust. App. 12-14. However, the certificate of deposit was security *and* a statutory trust. A trust is the best form of security. The very cases holding statutory trust funds not to be part of bankruptcy estates involved funds created as security. In *Selby v. Ford Motor Co., supra*, 590 F.2d 642, the Court of Appeals stated:

> "The Michigan act creates a *security device* in the form of a 'trust fund' for the benefit of the owner and subcontractors on construction projects: [Quotation from Michigan statute.]" *Id.* at 643. (Emphasis added.)

In re Marona, supra, 54 B.R. 65, involved a fund posted as *security* and held *not* to be part of the bankruptcy estate. *Id.* at 66-68. *Matter of Lenk, supra*, 44 B.R. 814, likewise involved a fund posted as *security* and held *not* to be part of the bankruptcy estate. *Id.* at 816-817. The language used in a statute does not determine absolutely whether compliance with it creates a statutory trust, and a statute

need not contain the words "trust," "trust funds," or "held in trust" in order to create a statutory trust. *Id.* at 816. If the intention is that the money shall be kept or used as a separate fund for the benefit of the payor or a third person, a trust is created. *Id.* at 816; *In re Pehkonen*, 15 B.R. 577, 581 (Bk. Ct. N.D. Iowa 1981). Such was the intention in the present case; money was intentionally set aside, under compulsion of state law, in a fund for a particular purpose. The elements of a statutory trust fund are (1) a statute, (2) a fund, and (3) a purpose. The present case has these three elements.

Taxel contended in the Court of Appeals that "there is no California authority which supports" the Board's "characterization of the [c]ertificate as a trust fund" and that "[t]his Court should not create a trust when California has not seen fit to do so." Appellee's Brief, p. 12. However, on February 25, 1939, the Attorney General of the State of California issued Opinion No. NS1462 (Appendix E, *infra*) which held that a bank account placed with the Board as security under section 11 of the Retail Sales Tax Act (Cal. Stats. 1933, ch. 1020, § 11, p. 2603), as section 6701 of the California Revenue and Taxation Code was then known, was a trust fund. The opinion stated:

> "It appears that the Board in certain cases requires retailers to make a deposit of cash or securities or to file a bond so as to secure the payment of taxes which may become due and payable by the retailer. Where cash is received the Board deposits it in a special fund in a bank, such special fund having been established with the approval of the Department of Finance.

> "Such moneys are not State moneys when so deposited, but constitute in a sense *a trust fund* and are not then payable into the State Treasury, nor do they come under the control of the State Controller.
>
> "In the event the tax liability is determined and paid and a balance remains in the account, the obligation of the Board is to return the same to the retailer making the deposit. App. 31-32. (Emphasis added.)

The opinion further stated:

> "Section 11 of the Sales Tax Act is dealing with a special matter involved in the collection of revenues due the State and to hold that moneys so received *in trust* from a taxpayer, pursuant to compulsion, are subject to the claims of general creditors would tend to defeat the very purpose of the section and might render it unworkable." App. 34. (Emphasis added.)

The opinion still further stated:

> "The Board does not become a debtor of the taxpayer in the ordinary sense; rather the Board has merely the obligation of returning to the taxpayer [in the event of no tax liability] that which already belongs to him and which the Board holds *in trust* for him." App. 34. (Emphasis added.)

The California Legislature reenacted section 11 of the Retail Sales Tax Act without rejecting the above opinion of the Attorney General. Cal. Stats. 1941, ch. 247, § 5, p. 1325. In addition, the California Legislature reenacted section 11 of the Retail Sales Tax Act as section 6701 of the Revenue and Taxation Code and, on several occasions, reenacted the latter section, all without rejecting the above opinion of the Attorney General. Cal. Stats. 1941,

ch. 36, § 1, p. 548; Cal. Stats. 1941, ch. 247, § 36, p. 1350; Cal. Stats. 1945, ch. 926, § 4.5, p. 1725; Cal. Stats. 1947, ch. 567, § 6, pp. 1557-1558; Cal. Stats. 1955, ch. 833, § 1, p. 1450.

The opinions of the Attorney General, while not binding, are entitled to great weight in the interpretation of a statute; and in the absence of controlling authority, such opinions are persuasive, since the Legislature is presumed to be cognizant of that construction of the statute. *Napa Valley Educators' Assn. v. Napa Valley Unified School Dist.*, 194 Cal.App.3d 243, 251, 239 Cal.Rptr. 395, 399 (1987). Although the opinions of the Attorney General are not of controlling authority, they are to be regarded as having a quasi-judicial character and are entitled to great respect. *People v. Berry*, 147 Cal.App.2d 33, 37, 304 P.2d 818, 822 (1956). Although the opinions of the Attorney General are not binding on the courts, they are accorded great weight in construing statutory provisions where controlling authority construing the provisions is absent. *A & B Cattle Co. v. City of Escondido*, 192 Cal.App.3d 1032, 1045, 238 Cal.Rptr. 580, 589 (1987). The opinions of the Attorney General are entitled to great weight. *Worthington v. Unemployment Ins. Appeals Bd.*, 64 Cal.App.3d 384, 388-389, 134 Cal.Rptr. 507, 510 (1976). The reenactment of a statutory provision which has a meaning well established by administrative construction is persuasive that the intent was to continue the same construction previously recognized and applied. *Cal. M. Express v. St. Bd. of Equalization*, 133 Cal.App.2d 237, 239-240, 283 P.2d 1063, 1065 (1955); *accord, Napa Valley Educators' Assn. v. Napa Valley Unified School Dist., supra,*

194 Cal.App.3d 243, 252, 239 Cal.Rptr. 395, 400. The failure of any interested party to challenge an administrative interpretation of a statute over many years is a factor entitled to much weight. *Mission Pak Co. v. State Bd. of Equalization*, 23 Cal.App.3d 120, 126, 100 Cal.Rptr. 69, 72 (1972); *Cal. M. Express v. St. Bd. of Equalization, supra*, 133 Cal.App.2d 237, 240, 283 P.2d 1063, 1065. "Not lightly vacated is the verdict of quiescent years." *Coler v. Corn Exchange Bank*, 250 N.Y. 136, 141, 164 N.E. 882, 884 (1928) (Cardozo, C. J.). Thus, California Attorney General's Opinion No. NS1462 correctly states the law of California. *The law of California is that a bank account placed with the Board as security under California Revenue and Taxation Code section 6701 is a trust fund.*

Whether or not a trust has been established is a matter of state law. *In re Crotts*, 87 B.R. 418, 420 (Bk. Ct. E.D. Va. 1988). A trust fund created under state law is not property of the bankruptcy estate. *In re Dunwell Heating & Air Conditioning Contr.*, 78 B.R. 667, 670-671 (Bk. Ct. E.D. N.Y. 1987). The legislative intention in enacting the Bankruptcy Code was to respect statutory trusts. *In re Casco Elect. Corp.*, 35 B.R. 731, 732 (Dist. Ct. E.D. N.Y. 1983). A trust is property outside the debtor's bankruptcy estate. *In re Grosso*, 9 B.R. 815, 823 (Bk. Ct. N.D. N.Y. 1981). The bankruptcy estate comprises no greater rights than the debtor had on the date of filing his bankruptcy petition. *In re Auto-Train Corp., Inc.*, 810 F.2d 270, 273 (D.C. Cir. 1987). The interest in property to which the bankruptcy trustee succeeds can be no greater than that which the debtor itself had. *In re Earl Roggenbuck Farms, Inc.*, 51 B.R. 913, 917 (Bk. Ct. E.D. Mich. 1985). The bankruptcy trustee can take no greater rights than the debtor himself had,

and this limitation upon the rights of the bankruptcy trustee applies particularly to property held in trust. *Mid-Atlantic Supply v. Three Rivers Aluminum Co.*, 790 F.2d 1121, 1124-1125 (4th Cir. 1986); *In re Crotts, supra*, 87 B.R. 418, 420. 11 U.S.C. § 541(c)(2) provides:

> "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable under this title."

The bankruptcy trustee's interests in a trust are limited to the debtor's interest therein. *Mid-Atlantic Supply v. Three Rivers Aluminum Co., supra*, 790 F.2d 1121, 1125; *Selby v. Ford Motor Co., supra*, 590 F.2d 642, 648. *In re American Intern. Airways, Inc.*, 70 B.R. 102 (Bk. Ct. E.D. Pa. 1987), held that funds segregated by the debtor and the bankruptcy trustee in trust for federal taxes, pursuant to a federal statute and an Internal Revenue Service notice requesting establishment of separate bank accounts, were payable in their entirety to the federal government on account of taxes due. *Id.* at 105. *The law of the United States is that a trust fund under state law is not property of a bankruptcy estate.*

The certificate of deposit was a trust fund under California law. A trust fund under state law is not property of a bankruptcy estate. The following words from *Selby v. Ford Motor Co., supra*, 590 F.2d 642, are appropriate here:

> "The trustee in bankruptcy should not be permitted to appropriate the trust of another and distribute it to the bankrupt's creditors." *Id.* at 648.

As the certificate of deposit was a trust fund which was never part of the taxpayer's bankruptcy estate, the Board correctly cashed it.

CONCLUSION

The decision of the Court of Appeals in the present case (1) conflicts with *Selby v. Ford Motor Co., supra,* 590 F.2d 642, (2) relies upon *United States v. Randall, supra,* 401 U.S. 513, which was overruled by *Begier v. I.R.S., supra,* 495 U.S. ___, 110 S.Ct. 2258, 110 L.Ed. 2d 46, (3) ignores 28 U.S.C. §§ 959(b) and 960, (4) negates Cal. Rev. & Tax. Code §§ 6701 and 6815, and (5) erroneously includes property within a bankruptcy estate. For the foregoing reasons, a writ of certiorari should issue to review the opinion and judgment of the Court of Appeals in the present case.

Respectfully submitted,

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(Appendices follow)

APPENDIX A

FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re SLUGGO'S CHICAGO STYLE, INC., *Debtor!*	No. 89-55040
CALIFORNIA STATE BOARD OF EQUALIZATION, *Appellant,* v. HAROLD S. TAXEL, Trustee, *Appellee.*	B.A.P. No. SC871688 OPINION

Appeal from the Ninth Circuit
Bankruptcy Appellate Panel
Jones, Ashland & Volinn, Judges, Presiding

Argued and Submitted
June 29, 1989 – Pasadena, California

Filed August 27, 1990

Before: Arthur L. Alarcon and Dorothy W. Nelson, Circuit Judges, and Paul G. Rosenblatt,* District Judge.

Opinion by District Judge Rosenblatt

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*Honorable Paul G. Rosenblatt, United States District Judge for the District of Arizona, sitting by designation.

COUNSEL

Herbert A. Levin, Deputy Attorney General, Los Angeles, California, for the appellant.

James P. Hill, Stephen K. Haynes, Hill & Baskin, San Diego, California, for the appellee.

OPINION

ROSENBLATT, District Judge:

Facts

The facts are undisputed. Pursuant to Cal. Rev. & Tax. Code § 6701, the California State Board of Equalization ("Board") required security, as a condition of doing business, from Sluggo's Chicago Style, Inc. ("debtor") for payment of California sales and use taxes.

In April of 1984, the debtor complied by providing this security in the form of a $9,100.00 certificate of deposit ("certificate") payable to the Board. In November of 1984, the debtor filed a petition for reorganization pursuant to Chapter 11 of the Bankruptcy Code. At the time, the debtor owed the Board $5,334.10. Sluggo's ceased doing business on February 28, 1986, at which time the debtor owed the Board in excess of the amount of the certificate. On August 1, 1986, the Board presented the certificate for payment. Some nineteen days later, the Chapter 11 proceeding was converted to Chapter 7.

The trustee brought the underlying action to recover the funds. On stipulated facts, the bankruptcy court

granted the trustee's Motion for Summary Judgment and denied the Board's Cross-Motion for Summary Judgment.

The Board appealed to the Bankruptcy Appellate Panel ("BAP"). The BAP entered judgment affirming the bankruptcy court holding that the Board violated the automatic stay of 11 U.S.C. § 362 by cashing the certificate and that the bankruptcy estate encompassed the funds deposited which should be distributed as provided by 11 U.S.C. § 724(b).

This appeal follows.[1]

Standard of Review

De novo review is appropriate in this case because the facts are undisputed and issues of credibility are not before the court. *In re Brown*, 743 F.2d 664, 666 (9th Cir. 1984). This court must determine only whether the Bankruptcy Appellate Panel's decision is correct as a matter of law.

Analysis

The board is authorized by statute to collect a security deposit from businesses in order to insure

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[1] On *November 27, 1989*, the Court ordered supplemental briefs to consider the effect on this case, if any, of *Hoffman v. Connecticut Department of Income Maintenance*, 2 J.J. White & R.S. Summers, *Uniform Commercial Code* 348 (3d ed. 1988) [sic] wherein the Supreme Court held that in enacting 11 U.S.C. Sec. 106(c), Congress did not abrogate the Eleventh Amendment immunity of the States. After reviewing the briefs, the court concludes that *Hoffman* is not applicable to the facts of this case.

compliance with statutory tax obligations. Cal. Rev. & Tax. Code § 6701. The Board argues that the monies collected in this fashion become property of the Board held in trust. Appellant relies in this regard on *Selby v. Ford Motor Co.*, 590 F.2d 642 (6th Cir. 1978), and other cases holding that monies held pursuant to a legislative enactment for the benefit of others constitute a trust and are immune from the claims of general creditors. *Selby*, 590 F.2d at 645 (Michigan Builders Trust Fund Act creates security device in form of trust fund for benefit of owner and subcontractors and should not be regarded as property of debtor so long as beneficial interests are traceable; *see also In re Rohar Associates, Inc.*, 375 F.Supp. 637 (S.D.N.Y. 1974) (funds held in account denominated tax account were held in trust by bankrupt for taxing authorities); *In re Lenk*, 48 Bankr. 867 (W.D. Wis. 1985) (fund that debtor and spouse were statutorily required to deposit with the state as security against payment of possible judgment was trust fund held by the state for benefit of injured plaintiffs).

United States v. Randall, 401 U.S. 513 (1971), however, supports a contrary position. In that case, the Supreme Court held that the United States was not entitled to first priority over withheld taxes which the debtor failed to deposit in a special tax account as directed by the bankruptcy court under a plan of reorganization. As in the instant case, the government argued that the withheld tax constituted a trust in its favor. The *Randall* Court, however, found otherwise noting that "the statutory policy of subordinating taxes to costs and expenses of administration would not be served by creating or enforcing trusts

which eat up an estate, leaving little or nothing for creditors and court officers whose goods and services created the assets." *Id.* at 994.

Following the reasoning of *Randall*, this court held in *In re Shakesteers Coffee Shops*, 546 F.2d 821, 824 (9th Cir.), *cert. denied*, 431 U.S. 974 (1977), that trust fund recognition may adversely affect sound administration in bankruptcy. Earlier, in *In re Tamasha and Country Club*, 483 F.2d 1377 (9th Cir. 1973), we refused to recognize a trust implied in law for the benefit of taxing authorities, finding that taxes accruing after the institution of Chapter 11 proceedings were administrative expenses. In so holding we expressly rejected the government's attempt to distinguish *Randall*.

In a slightly different vein, appellant argues additionally that we should defer to the State of California's intention to create a trust in these circumstances as expressed in a letter submitted to the Board in 1939 by Earl Warren, who was then state attorney general. This letter states that

> [t]he Board does not become a debtor of the taxpayer in the ordinary sense; rather, the Board merely has the obligation of returning to the taxpayer that which already belongs to him and which the Board holds in trust for him.

While we consider significant the statutory construction given by officials charged with the statute's administration, *Mission Pak Co. v. State Bd. of Equalization*, 100 Cal.Rptr. 69, 71 (Cal.App. 1972), we do not agree that the Attorney General's letter indicates an intention to create a trust; it appears instead to define the Board's role as that of a custodian of the funds deposited, a reading consistent with the case law of this circuit. *See e.g., Kennedy v.*

Powell, 366 F.2d 346 (9th Cir. 1966) (Arizona State Trea surer is "mere custodian" and not owner of cash deposi made by contractor as condition precedent to granting o contractor's license).

Were there evidence before this court indicating tha the Board's construction of the letter had been previousl recognized and applied, appellant's position would b greatly strengthened. *See California Motor Express v. Stat Bd. of Equalization*, 283 P.2d 1063 (Cal.App. 1955). Th Board has failed, however, to produce any such evidence

Rather than a statutory trust, appellee characterize the monies collected by the Board as a security interes created by pledge. While the certificate at issue could b classified in this and a number of other ways,[2] we nee not properly label it. In light of the broad interpretatio of the term "property" for the purposes of the Bank ruptcy Act, *see Segal v. Rochelle*, 86 S.Ct. 511, 515 (1986 we find that property seized by a creditor prior to th filing of a petition for reorganization pursuant to chapte 11 belongs to the bankruptcy estate. *See United States Whiting Pools, Inc.*, 462 U.S. 198 (1983).

Conclusion

For the foregoing reasons, we agree with the Bank ruptcy Appellate Panel that the statutory scheme at issu

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[2] For example, the appellant's interest could just as well b labeled a future contingent interest in that the Board was n entitled to actual payment until the debtor ceased doing bus ness and then only if the debtor owed taxes. Cal. Rev. & Ta Code § 6815.

in this case does not suggest that the creation of a trust was contemplated. Accordingly, the Board had no right to cash appellee's certificate of deposit which was properly part of the bankruptcy estate.

AFFIRMED.

APPENDIX B

ORDERED PUBLISHED

UNITED STATES BANKRUPTCY APPELLATE PANELS
OF THE NINTH CIRCUIT

In re SLUGGO'S CHICAGO STYLE, INC., Debtor.	BAP No. SC 87-1668 VAJ BK. No. 84-05101-M7
HAROLD S. TAXEL, Trustee, Plaintiff/Appellee, v. CALIFORNIA STATE BOARD OF EQUALIZATION, Defendant/Appellant.	ADV. No. C86-0705-M7 OPINION

Argued and Submitted:
November 18, 1987 at Pasadena

Filed: December 9, 1988

Appeal from the United States Bankruptcy Court
for the Southern District of California

Hon. James W. Meyers, Bankruptcy Judge, Presiding

Before: VOLINN, ASHLAND and JONES, Bankruptcy Judges

VOLINN, Bankruptcy Judge:

FACTS

The debtor, prior to bankruptcy (initiated by a Chapter 11 petition, subsequently converted to Chapter 7), was

obligated to appellant, State Board of Equalization (board), for unpaid sales and use taxes. Pursuant to statute, the Board required that the debtor, as a condition of doing business, provide security in the sum of $9,100 which would be available for application to taxes which might be unpaid in the event the debtor closed its business. The security was provided in the form of a bank certificate of deposit, acknowledging deposit by the debtor on April 9, 1984, payable to and placed in the possession of the Board prior to bankruptcy. Thereafter, on November 26, 1984, a Chapter 11 proceeding was instituted by the debtor. The debtor, on that date, according to appellant's priority tax claim, owed the state $5,334.10. The case was converted from a Chapter 11 to a Chapter 7 proceeding on August 19, 1986.

It was stipulated by the parties, in the course of oral argument before this panel, that the debtor in possession during the period of its Chapter 11 operation, some twenty-two months, did not pay sales and use taxes. Further, the unpaid taxes accruing during the Chapter 11 administration exceeded the $9,100 certificate of deposit.

The debtor ceased its operations and discontinued its business on February 28, 1986, some six months before conversion to Chapter 7. The Board presented the certificate of deposit and the depository bank paid it the sum of $9,016.02 on or about August 1, 1986, some nineteen days prior to conversion from Chapter 11 to Chapter 7.

ISSUES

The trustee, appellee herein, concedes the perfection of the bank's security interest in the certificate of deposit.

However, he contends that the Board, by cashing the certificate, violated the automatic stay of 11 U.S.C. § 362; additionally, the funds should be returned to the trustee subject to distribution pursuant to 11 U.S.C. § 724(b), which renders the Board a priority, rather than a secured, claimant.

The Board contends that the deposit was in the nature of a trust fund wherein the estate has no interest by virtue of 11 U.S.C. § 541(d); and, further, that (1) the debtor in possession as a fiduciary and trustee should be held to its duty to have paid the taxes during the administration of the Chapter 11 estate and (2) the deposited funds were security for the estate to fulfill this obligation. The Board also claims that the accrued taxes which were not paid during the administration of the estate are themselves expenses of administration based on the state's post-bankruptcy claim and, therefore, not subject to the subordinate priority level set by section 724(b), which is applicable to prebankruptcy claims.

The court below ruled that, while the Board held a security interest, the funds represented by the certificate of deposit were property of the bankruptcy estate; thus, in presenting the certificate of deposit to the bank for payment, the Board violated the automatic stay. The trustee was held entitled to the proceeds of the certificate, and the Board was required to return $9,100 plus interest to the estate subject to distribution pursuant to section 724(b) of the Bankruptcy Code.

STANDARD OF REVIEW

This matter was decided on the basis of the trustee's motion for summary judgment and the Board's cross-motion for summary judgment. The trustee's motion was granted and the cross-motion denied. The bankruptcy court's granting of a summary judgment is a determination as a matter of law and is therefore reviewed *de novo*. *In re Bullion Reserve of North America*, 836 F.2d 1214, 1216 (9th Cir. 1988), *cert. denied*, ___ U.S. ___, 108 S.Ct. 2824; *In re Stephens*, 51 B.R. 591, 595 (9th Cir. BAP 1985).

DISCUSSION

I. The Nature of the Certificate of Deposit

A bankruptcy estate can include property on which taxing authorities have a lien. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 206-07 (1983). In contrast, a bankruptcy estate ordinarily does not include monies held in trust for a creditor or third party. *Selby v. Ford Motor Co.*, 590 F.2d 642, 645 (6th Cir. 1979).

The threshold question, therefore, is whether the certificate of deposit became part of the bankruptcy estate. If not, the automatic stay did not apply. *See In re Fresh Approach, Inc.*, 51 B.R. 412, 423 (Bankr. N.D. Tex. 1985); *In re Tinnell Traffic Servs., Inc.*, 43 B.R. 277, 278 (Bankr. M.D. Tenn. 1984).

Courts are to resolve the questions of whether a debtor has interest in a given asset by reference to state, non-bankruptcy law. *In re Farmers Mkts., Inc.*, 792 F.2d 1400, 1402 (9th Cir. 1986); *see also In re Petite Auberge Village, Inc.*, 650 F.2d 192 (9th Cir. 1981).

The following two California statutes create Board rights in property of a delinquent taxpayer:

Cal. Rev. & Tax. Code § 6701, providing:

> (1) The Board, whenever it deems it necessary to ensure compliance with this part (Cal. Rev. & Tax. Code §§ 6001-7176) may require any person subject thereto, to place with it such *security* as the Board may determine (emphasis supplied); and

Cal. Rev. & Tax. Code § 6815, providing:

> (2) *If at the time a business is discontinued* the board holds *security* pursuant to Section 6701 in the form of cash, government bonds, or insured deposits in banks or savings and loan institutions, such security *when* applied to the account of the taxpayers shall be deemed to be a payment on account of any liability of the taxpayer to the board *on the date the business is discontinued.* (Emphasis supplied.)

The parties in a Stipulation of Facts submitted to the trial court stated, *inter alia*:

> 1. On April 9, 1984, Sluggos Chicago Style, Inc. (the debtor) placed with the Board *security* as required by Cal. Rev. & Tax. Code § 6701, in the form of a certificate of deposit payable to the Board in the sum of $9,100. A copy of the certificate of deposit is attached as exhibit A hereto. (Emphasis supplied.)

The Board contends that despite the statutory and stipulated terminology relating to security, the deposit was a trust fund; because the security had been subjected to the exclusive control of the state, the property was held in trust and not part of the bankruptcy estate as provided for by 11 U.S.C. § 541(d). That section includes in the

estate "property in which the debtor holds, as of the commencement of the case, only legal title . . . but not to the extent of any equitable interest in such property that the debtor does not hold."

The Board heavily relies on *Selby*, and further cites cases such as *In re Pelham Fence Co., Inc.*, 65 B.R. 924 (Bankr. S.D.N.Y. 1986); *In re Marona*, 54 B.R. 65 (Bankr. N.D. Ala. 1985); and *In re Lenk*, 48 B.R. 867 (W.D. Wis. 1985). The foregoing cases are distinguishable.

Selby involved a state statute which designated funds of a third party, that is the builder's contruction [sic] fund, as a trust fund. The statute was entitled "Michigan Builder's Trust Fund Act." The statute provided as follows:

> In the building construction industry, the building contract fund paid by any person to a contractor . . . shall be considered by this Act to be a trust fund for the benefit of (1) the person making the payment and (2) contractors, laborers, subcontractors or materialmen, and the contractor . . . shall be considered the trustee of all the funds so paid to him for building construction purposes.

The trustee in bankruptcy in *Selby* sought to set aside payments to the subcontractors as preferential transfers. The court held that the funds, which were literally subject to a statutory trust, never came into the hands of the estate, and that the trustee could not regain these funds by way of preference actions against the subcontractors.

The *Marona* and *Lenk* cases involved funds which had been deposited with the state by uninsured motorists. In both cases, judgments had been entered and attached to

the funds. In *Pelham Fence*, the debtor was a contractor who had engaged in a public works contract from which funds were held to pay employees of the contractor. The court, without citing *Selby*, stated that this was a case where prepetition funds were segregated and held in trust for the benefit of certain parties concluding:

> The subsequent commencement of a bankruptcy case by or against the employer should not enhance or elevate the rights of the employer-debtor or those of the employer's trustee in bankruptcy with respect to the withheld funds.

Pelham Fence, 65 B.R. at 928. This case, therefore, supports the argument of appellee rather than that of the appellant. *Lenk* might be read the Board's way, but involved a judgment which, although questionable, the District Court found on appeal to have appropriately attached to the deposit.

II. Applicability of the Certificate of Deposit for Payment of the Post-Bankruptcy Taxes

A.

It was stipulated by the parties, as indicated, that the unpaid post-bankruptcy tax debt exceeded the funds held by the certificate of deposit. The trustee contends that the state was negligent in not monitoring the payment of taxes (or non-payment thereof) by the debtor in possession for a period of nearly two years. The state, on the other hand, cites (1) 28 U.S.C. § 959(b), which provides:

> Except as provided in section 1166 of Title 11 [not relevant to this matter], a trustee, receiver or manager appointed in any cause pending in

> any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof;

and (2) 28 U.S.C. § 960, which provides:

> Any officers and agents conducting any business under authority of a United States court shall be subject to all federal, state and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

It may also be noted that 11 U.S.C. § 1107 specifies the rights, powers, and duties of a debtor in possession. This section imposes on the debtor in possession the obligations of a trustee serving under Chapter 11 set forth in 11 U.S.C. § 1106(a), which in turn requires the Chapter 11 trustee to perform substantially all the duties specified for a Chapter 7 trustee in 11 U.S.C. § 704. Among these duties are those specified in subsection 8, which states:

> If the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with the responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires; . . .

In this regard, appellant points also to title 28, section 960, above quoted, as specifically requiring the debtor to

maintain its pre-bankruptcy tax security while it continued to operate the business.

Viewing the matter from the perspective of hindsight, the debtor's conduct in flouting its obligations under various statutes of the United States, including the specific direction of the Bankruptcy Code, is inexcusable. The question, however, is whether or nor the pre-bankruptcy deposit may be considered as having been carried over in that form into the bankruptcy case. This in turn raises an issue as to whether it was necessary for the debtor as a trustee to have requested permission to dedicate a pre-bankruptcy fund in which the debtor had an interest to, or made security for, a post-bankruptcy purpose. Section 363(c)(1) of the Code provides that:

> If the business of the debtor is authorized to be operated under section 721, 1108, . . . and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

It is problematical as to what the court would have ordered. However, it is clear that section 6701 of the California Revenue & Tax Code, quoted above, contemplates the Board obtaining security deposits "whenever it deems it necessary to ensure compliance." Requiring security is an enforcement procedure following on delinquency in payment of taxes. This sequence of events, delinquency and furnishing of security, is not the ordinary course of business. Moreover, 28 U.S.C. §§ 959(b) and 960 impose on fiduciaries, such as the debtor in

possession, a specific and affirmative obligation to comply with state law and pay taxes while operating a business.

In any event, there is nothing in the record to suggest that the Board relied on the security deposit to cover, not only its pre-bankruptcy claim against the debtor, but also any post-bankruptcy claim against the debtor in possession. Although the conduct of the debtor, as debtor in possession, was irresponsible, and the state may ascribe its passivity over a period of almost two years to reliance on the debtor's compliance with the law as well as the deposit, there does not appear to be any impelling legal or equitable reason for transforming the prebankruptcy character of the deposit into a post-bankruptcy security interest or trust.

B.

We note that the drawing down of the deposit was accomplished prior to the termination of Chapter 11 and that, by virtue of 11 U.S.C. § 103, section 724 can only apply in a case under Chapter 7. However, the automatic stay provision of 11 U.S.C. § 362 is applicable in Chapter 11. Section 362(a)(4) stays, generally, "any act to create, perfect, or enforce any lien against property of the estate;" section 362(a)(5) affects in the same manner any lien to the extent "that such lien secures a claim that arose before commencement of the case under this title. . . . " The action of the state in enforcing any portion of its security interest by cashing in the certificate was in violation of the automatic stay. An action taken in violation of the stay is void. *Kalb v. Feuerstein* 308 U.S. 433, 438 (1940);

In re Wingo, 89 B.R. 54, 57 (9th Cir. BAP 1988). Because the Board acted in violation of section 362, its action during Chapter 11 (when section 724 presumably did not apply) cannot provide justification for retention of the funds obtained by cashing the certificate of deposit.

As the deposit is an asset of the estate, it would be subject to disposition under section 724(b), which divests or subordinates the security interest of a taxing agency to a sixth level priority unsecured claim pursuant to 11 U.S.C. § 507(a). Even though this treatment may be in derogation of a lawfully acquired lien, such subordination results from long standing policy which antedates the present Bankruptcy Code. *United States v. Randall*, 513, 517 (1971); *In re Tamasha Town & Country Club*, 483 F.2d 1377, 1379 (9th Cir. 1973).[1]

CONCLUSION

The problem of whether or not property is subject to any claim of interest by the bankruptcy estate is long

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[1] "We think the statutory policy of subordinating taxes to costs and expenses of administration would not be served by creating or enforcing trusts which eat up an estate, leaving little or nothing for creditors and court officers whose goods and services created the assets. In *Nicholas v. United States*, 384 U.S. 678, 690-692, we rejected the claim of the United States that under section 7501(a) of the Internal Revenue Code it was entitled to interest accruing after the arrangement under chapter XI and during the bankruptcy. We so held because to allow interest would run counter to the 'strong policy of § 64(a)(1) of the Bankruptcy Act'. *Id.*, at 691. To allow the present claim priority for the principal would by the same token run counter to the grain of the Bankruptcy Act." *United States v. Randall*, 401 U.S. 513, 517 (1971).

outstanding and frequently litigated. *See Whiting Pools*, 462 U.S. 198; *In re Anchorage Int'l Inn, Inc.*, 718 F.2d 1446 (9th Cir. 1983). The question has also been considered extensively under the preference section of the Bankruptcy Code, 11 U.S.C. § 547, when the defense has been tendered that the subject matter of the transfer was not property of the estate. The latter issue was dealt with in cases such as *In re Olympic Foundry Co.*, 63 B.R. 324 (Bankr. W.D. Wash. 1986), *rev'd on other grounds*, 71 B.R. 216 (9th Cir. BAP 1987), and *Drabkin v. District of Columbia*, 824 F.2d 1102 (D.C. Cir. 1987), both of which reviewed, in depth, legislative history and case law.

Considering the variety and complexity of these cases, the need to review the matter before us in the light of its applicable statutes and facts is apparent. From this perspective, it is clear that the California statutes provide for creation of a security interest, enforceable on the happening of a specified event, cessation of business. On this basis, the Board was a secured creditor for a pre-bankruptcy debt of some $5,000 on the date of bankruptcy when the automatic stay of 11 U.S.C. § 362 intervened. The nature of the Board's interest having been defined on that date, without change thereafter, its claim was subject to the character and priority imposed on it by the Bankruptcy Code.

We conclude that the bankruptcy estate encompassed the funds deposited by way of security and that the court's requirement, that the funds be returned to the estate subject to distribution as provided for by 11 U.S.C. § 724(b), was appropriate. We therefore affirm.

APPENDIX C

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Attorneys for Plaintiff/Trustee

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re SLUGGO'S CHICAGO STYLE, INC., Debtor. Case No. 84-05101-M7 Southern District of California	ADV. NO. C86-0705-M7 FINAL JUDGMENT (Filed June 15, 1987)
HAROLD S. TAXEL, Trustee, Plaintiff, v. CALIFORNIA STATE BOARD OF EQUALIZATION and LA JOLLA BANK & TRUST CO., Defendants.	

This action came on for hearing before the Bankruptcy Court, the Honorable James W. Meyers presiding, and the issues having been duly heard and a decision having been duly rendered,

IT IS ORDERED AND ADJUDGED:

1. On the First Claim for Relief, the California State Board of Equalization shall promptly turnover to the bankruptcy estate the sum of $9,100.00, plus accrued simple interest at 5.50% per annum from April 9, 1986 to the date of turnover. This sum shall be in the form of a certificate of deposit drawn on a financial institution on the list of approved bankruptcy depositories. The certificate of deposit shall be subject to the condition that no payment shall be made without an order of this Court in Sluggo's Chicago's Style, Inc., case no. 84-05101-M7.

2. On the Second Claim for Relief, the certificate of deposit mentioned in the immediately preceding paragraph shall be held pending distribution according to section 724 of the Bankruptcy Code.

3. On the Third Claim for Relief, the trustee shall take no additional damages for the violation of the automatic stay.

4. The trustee shall have his costs of suit.

DATED: 15 JUN 1987

JAMES W. MEYERS
UNITED STATES
BANKRUPTCY JUDGE

Submitted by:

HILL & BASKIN

By: /s/ Stephen K. Haynes
Stephen K. Haynes, Esq.
Attorneys for Trustee

Approved as to Form:

JOHN VAN de KAMP
California Attorney General

By:/s/ Herbert A. Levin
Herbert A. Levin,
Deputy Attorney General
Attorneys for California
State Board of Equalization

APPENDIX D

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Attorneys for Plaintiff/Trustee

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re SLUGGO'S CHICAGO STYLE, INC., Debtor. Case No. 84-05101-M7 Southern District of California	ADV. NO. C86-0705-M7 ORDER ON CROSS-MOTIONS FOR SUMMARY JUDGMENT Date: May 29, 1987 Time: 1:45 p.m. Dept: One Hon. James W. Meyers (Filed June 15, 1987)
HAROLD S. TAXEL, Trustee, Plaintiff, v. CALIFORNIA STATE BOARD OF EQUALIZATION and LA JOLLA BANK & TRUST CO., Defendants.	

The motion for summary judgment of the California State Board of Equalization ("Board") and the cross-motion for summary judgment of trustee Harold S. Taxel ("the trustee") came on regularly for hearing in Department One of the United States Bankruptcy Court, the

Honorable James W. Meyers presiding. The Board appeared by its counsel Deputy Attorney General Herbert A. Levin. The trustee appeared by his counsel Hill & Baskin by Stephen K. Haynes. The Court has considered the pleadings filed in support of and in opposition to the motion and cross-motion for summary judgment, the stipulation of facts (a copy of which is attached as Exhibit "1" hereto), and the argument of counsel, and good cause appearing therefore,

IT IS ORDERED, ADJUDGED, AND DECREED:

1. The Certificate of Deposit in the face amount of $9,100.00 is property of the bankruptcy estate.

2. The interest of the Board in the Certificate of Deposit is a lien which is subject to distribution pursuant to section 724(b) of the Bankruptcy Code.

3. In presenting the Certification of Deposit to La Jolla Bank & Trust Co. for payment, the Board violated the automatic stay.

4. The trustee is entitled to the proceeds of the Certificate of Deposit plus the interest which would have accrued in the absence of the Board's violation of the automatic stay.

5. The Board must return to the estate $9,100.00 plus simple interest at the rate of 5.50% per annum from April 9, 1986 until the Board obtains a new certificate of deposit.

6. The Board shall tender the sum described in the immediately preceding paragraph to the estate in the form of a certificate of deposit drawn on a financial

institution on the list of approved depositories for bankruptcy funds. The certificate of deposit shall not be presented for payment until further order of this Court in the Chapter 7 proceeding of Sluggo's Chicago Style, Inc., case no. 84-05101-M7.

7. The trustee is not entitled to recover additional damages from the Board – such as his attorneys fees – for violation of the automatic stay.

8. The Board's motion for summary judgment is denied. The trustee's cross-motion for summary judgment is granted in part and denied in part.

9. The trustee shall submit a judgment in accordance with this order.

DATED: 15 JUN 1987

/s/ James W. Meyers
UNITED STATES
BANKRUPTCY JUDGE

Submitted by:

HILL & BASKIN
By: /s/ Stephen K. Haynes
Stephen K. Haynes, Esq.
Attorneys for Trustee

Approved as to Form:

JOHN K. VAN de KAMP
CALIFORNIA ATTORNEY GENERAL

By: /s/ Herbert A Levin
Herbert A. Levin
Deputy Attorney General
Attorneys for California
State Board of Equalization

EXHIBIT 1

HILL & BASKIN
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Stephen K. Haynes
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(619) 235-6801

Attorneys for Plaintiff/Trustee

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re SLUGGO'S CHICAGO STYLE, INC., Debtor. Case No. 84-05101-M7 Southern District of California	ADV. NO. C86-0705-M7 STIPULATION OF FACTS Date: May 29, 1987
HAROLD S. TAXEL, Trustee, Plaintiff, v. CALIFORNIA STATE BOARD OF EQUALIZATION and LA JOLLA BANK & TRUST CO., Defendants.	Time: 1:45 p.m. Dept: 1 Hon. James W. Meyers (Filed March 27, 1987)

Plaintiff Harold S. Taxel, trustee of the above-entitled bankruptcy estate, and defendant California State Board

of Equalization (the "Board") hereby stipulate to the following facts for the purpose of the above-entitled adversary proceeding only:

1. On April 9, 1984, Sluggo's Chicago Style, Inc. (the "debtor") placed with the Board security, as required by California Revenue and Taxation Code section 6701, in the form of a certificate of deposit payable to the Board in the sum of $9,100.00. A copy of the certificate of deposit is attached as Exhibit "A" hereto.

2. On February 28, 1986, the debtor discontinued its business.

3. On February 28, 1986, the debtor was indebted to the Board under the Sales and Use Tax Law of the State of California in an amount in excess of $9,100.00.

4. On August 1, 1986, the Board presented the certificate of deposit to the depositary bank for payment to the Board.

5. On August 1, 1986, the bank paid the Board the sum of $9,016.02. This sum represented the face amount of the certificate ($9,100.00) plus accrued interest ($41.14) minus a penalty for withdrawal between periodic maturity dates ($125.12).

DATED: March 24, 1987

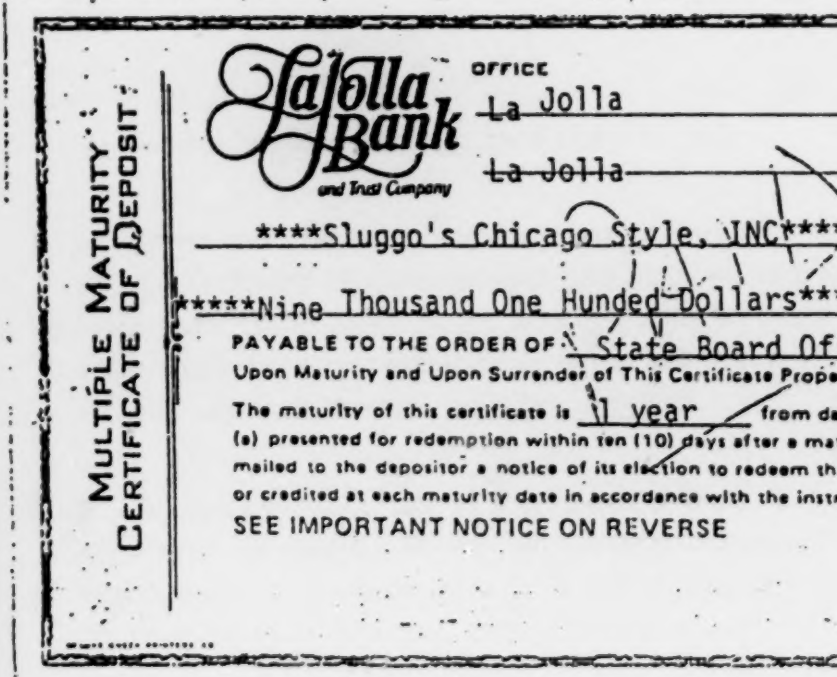
HILL & BASKIN

By: /s/ Stephen K. Haynes
Stephen K. Haynes
Attorneys for Plaintiff

DATED: March 25, 1987

JOHN K. VAN DE KAMP, Attorney
General of the State of
California
EDMOND B. MAMER, Supervising
Deputy Attorney General
HERBERT A. LEVIN,
Deputy Attorney General
By: /s/ Herbert A. Levin
Herbert A. Levin
Attorneys for Defendant

EXHIBIT A



MULTIPLE MATURITY CERTIFICATE OF DEPOSIT

La Jolla Bank and Trust Company

OFFICE La Jolla

~~La Jolla~~

****Sluggo's Chicago Style, INC****

*****Nine Thousand One Hunded Dollars****

PAYABLE TO THE ORDER OF State Board Of

Upon Maturity and Upon Surrender of This Certificate Prope

The maturity of this certificate is 1 year from da

(s) presented for redemption within ten (10) days after a ma

mailed to the depositor a notice of its election to redeem th

or credited at each maturity date in accordance with the inst

SEE IMPORTANT NOTICE ON REVERSE

ACCOUNT NUMBER 01442171-40

4069

CALIF. 92037 4-9 1984

HAS DEPOSITED

*** DOLLARS S 9100.00

Equalization

rly Endorsed.

te. This certificate will be renewed automatically for a similar period unless: turity date or (b) not less than 30 days prior to a maturity date the bank has is certificate. Interest at the rate of 5.50 % per annum will be paid ructions of the depositor.

NO INTEREST AFTER MATURITY

R. Joan O'Brien

AUTHORIZED SIGNATURE

IMPORTANT NOTICE

You have contracted to keep your funds on deposit for the full period of time stated in this certificate of deposit. In the event the Bank, notwithstanding the contract provisions, permits withdrawal of all or a portion of the funds before maturity, federal law requires the following penalties.

1. Interest on the amount withdrawn will be reduced to the Bank's regular savings rate then in effect.

2. Three months in interest on the amount withdrawn will be forfeited if that amount has been on deposit for more than three months. If, however, the amount withdrawn has been on deposit for three months or less, all interest on that amount will be forfeited.

3. To comply with the above requirements, it may be necessary to deduct from the amount requested to be withdrawn, a portion of any interest already paid or credited to your account. The penalties stated above also apply to reinvestment for like periods unless the funds are withdrawn at maturity or within ten (10) days thereafter.

Pay to the Order of
the State Board of Equalization
/s/ Joan M Foomire

APPENDIX E

CAL. ATTY. GEN.
OPINION NO. NS1462 (1939)

STATE OF CALIFORNIA

LEGAL DEPARTMENT

San Francisco, February 25, 1939.

State Board of Equalization,
Sacramento, California.

Attention: Honorable Dixwell L. Pierce, Secretary.

Gentlemen:

I have your letter of February 10, 1939, in which you ask for my opinion as to the applicability of Section 710 of the Code of Civil Procedure to money or securities deposited with the Board by a retailer pursuant to the provisions of Section 11 of the Retail Sales Tax Act.

Section 11 reads in part as follows:

> "The board * * * may require any person subject to the tax * * * to deposit with it such security as the board may determine. The same may be sold by the board at public sale if it becomes necessary * * * . Upon any such sale, the surplus, if any, above the amounts due under this act shall be returned to the person who deposited the security."

It appears that the Board in certain cases requires retailers to make a deposit of cash or securities or to file a bond so as to secure the payment of taxes which may become due and payable by the retailer. Where cash is received the Board deposits it in a special fund in a bank,

such special fund having been established with the approval of the Department of Finance.

Such moneys are not State moneys when so deposited, but constitute in a sense a trust fund, and are not then payable into the State Treasury, nor do they come under the control of the State Controller.

In the event the tax liability is determined and paid and a balance remains in the account, the obligation of the Board is to return the same to the retailer making the deposit. That this is so clearly appears from the language of Section 11 that

> "Upon any such sale (of a security), the surplus, if any, above the amounts due under this act shall be returned to the person who deposited the security."

Of course, where cash is accepted in lieu of securities, the surplus of such cash must likewise be returned to the person depositing the same.

Section 710, Code of Civil Procedure, so far as material here, reads as follows:

> "(a) Whenever a judgment for the payment of money is rendered by any court of this State against a defendant to whom money is owing and unpaid by this State or by any county, city and county, city or municipality, quasi municipality or public corporation, the judgment creditor may file a duly authenticated abstract or transcript of such judgment together with an affidavit stating the exact amount then due, owing and unpaid thereon and that he desires to avail himself of the provisions of this section in the manner as follows:

"1. If such money, wages or salary is owing and unpaid by this State to such judgment debtor, said judgment creditor shall file said abstract or transcript and affidavit with the State department, board, office or commission owing such money, wages or salary to said judgment debtor prior to the time such State department, board, office or commission presents the claim of such judgment debtor therefor to the State Controller or to the State Personnel Board. Said State department, board, office or commission in presenting such claim of such judgment debtor to said State Controller shall note thereunder the fact that (of) the filing of such abstract or transcript and affidavit and state the amount unpaid on said judgment as shown by said affidavit and shall also note any amounts advanced to the judgment debtor by, or which the judgment debtor owes to, the State of California by reason of advances for expenses or for any other purpose. Thereupon the State Controller, to discharge such claim of such judgment debtor, shall pay into the court which issued such abstract or transcript by his warrant or check payable to said court the whole or such portion of the amount due such judgment debtor on such claims, after deducting from such claim an amount sufficient to reimburse the State department, board, officer or commission for any amounts advanced to said judgment debtor or by him owed to the State of California, as will satisfy in full or to the greatest extent the amount unpaid on said judgment and the balance thereof, if any, to the judgment debtor."

In view of the fact that payment to a judgment creditor must be made by warrant or check drawn by the Controller, it seems to follow that the provision of Section 710 can apply only in cases where such check or warrant may be drawn on funds in the State Treasury, or at least

on funds of which the Controller has custody and control. That Section 710 cannot apply where securities are held in trust by a State board seems obvious.

I am also of the opinion that Section 710 is not applicable to cash held by the Board in a special deposit account, either before or after determination of the tax liability of the depositor.

Section 11 of the Sales Tax Act is dealing with a special matter involved in the collection of revenues due the State and to hold that moneys so received in trust from a taxpayer, pursuant to compulsion, are subject to the claims of general creditors would tend to defeat the very purpose of the section and might render it unworkable.

A number of other reasons might be suggested why Section 710 is not applicable here. One is that the relation of debtor and creditor, as contemplated by Section 710, does not exist here. The Board does not become a debtor of the taxpayer in the ordinary sense; rather, the Board has merely the obligation of returning to the taxpayer that which already belongs to him and which the Board holds in trust for him.

It might also be said that Section 710, construed along with Section 710a, seems to refer to debts or obligations owed by the State, as such, for wages or salaries, or for contract liabilities, payable out of the State Treasury only.

In this connection, see *Welch v. Payne*, 110 Call. App. 378.

We believe it advisable to say that this opinion is limited to the particular question submitted, namely, the application of Section 710, Code of Civil Procedure, and that we are not here passing on the possible application of other statutes, such as statutes authorizing attachment, garnishment or execution.

Very truly yours,

EARL WARREN,
ATTORNEY GENERAL,

By H. H. Linney,
Deputy.

HHL:EP

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JJA
RWH